SOCIÉTÉ DES LOTERIES ET COURSES DU QUÉBEC

SIXTEENTH ANNUAL REPORT

1985-1986

loto-québec

LOTO-QUÉBEC
For the Fiscal Year
April 1, 1985
to March 31, 1986.

BOARD OF DIRECTORS

*‡David Clark
President and Director-General

Denis Vandry
Deputy Director-General and Vice-president, Horse-Racing

**Marthe Bouchard-Hatch
**Reynald Brisson
*Jacques Desmeules, c.a.
*Francine Harel-Giasson

Secretary
Marguerite Bourgeois-Lapierre

*Members of the Audit Committee
**Members of the Salary and Benefits Committee

MANAGEMENT COMMITTEE

President
Vice-president, Corporate Affairs
Vice-president, Horse-Racing
Vice-president, New Markets
Vice-president, Systems
Vice-president, Lotteries
Manager of the President's Office
Manager of Human Resources

GENERAL MANAGEMENT

Manager of the President's Office
Pierre l'Archevêque — Assistant to the President

Manager of Human Resources
Jean-Pierre Sylvestre

Manager of Internal Auditing
Jacques Dubois

VICE-PRESIDENT, CORPORATE AFFAIRS
Marguerite Bourgeois-Lapierre

Director of Public Affairs
Michel Labrosse

Planning Department

Legal Department

Documentation Management Department

VICE-PRESIDENT, HORSE-RACING
(Sodic Québec Inc.)
Denis Vandry

VICE-PRESIDENT, NEW MARKETS
Roger Bertrand

VICE-PRESIDENT, SYSTEMS
Gaston Thibault

Manager, Games Systems
Robert Durocher

Manager, Managing Systems
Jean-Marie Dumont

Managing Systems Operations Department

Quality-Insurance and Security Department

Information Management Department

VICE-PRESIDENT, LOTTERIES
Claude Trudel

Manager, Finance and Physical Resources
Gilles Dubé

Manager,
Sales and Distribution
Hervé Bellerive

Manager, Marketing
Robert Ayotte

Manager, Games-Network Processing
Rosaire Bachand

HEAD OFFICE

LOTO-QUÉBEC
Sodic Québec inc.
Lotim Inc.
500, Sherbrooke Street West
Montréal H3A 3G6
(514) 282-8000

OPERATIONS CENTRES

Laval
1699, St-Martin Blvd. West
Laval H7S 1N2
(514) 682-2525

Montréal-Ouest
1238, Beaumont Street
Town of Mount Royal
H3P 3E3
(514) 735-4133

Montréal-Est
7070, Beaubien Street East
Anjou H1M 1B2
(514) 873-2603

Montréal-Sud
470, Ste-Foy Street
Longueuil J4J 1Y2
(514) 651-9282

Québec
2200, Charest Blvd. West
Sainte-Foy G1N 2G3
(418) 643-8996

REGIONAL OFFICES

Sherbrooke
145, Radisson Street
Sherbrooke J1L 1E2
(819) 566-2161

Chicoutimi
345, des Saguenéens Street
Chicoutimi G7H 6K9
(418) 545-4522

Rimouski
92, 2nd Street West
Rimouski G5L 8B3
(418) 722-3658

Trois-Rivières
5000, Jean XXII Blvd.
Trois-Rivières West G8Z 4L1
(819) 373-2633

Hull (May 1986)
975, Saint-Joseph Blvd.
Suite 220
Hull J8Z 1W8
(819) 778-0586

PRESIDENT'S REPORT

During the past fiscal year, Loto-Québec has continued to benefit from the momentum provided by its dynamic team of managers which was formed during recent years under the leadership of my predecessor. Therefore, I wish to pay homage at the beginning of this, my first fiscal review, to Mr. Jean-Marc Lafaille, one of the true lottery pioneers.

Upon my appointment last June, I decided to surround myself by a broadened Management Committee as well as make some adjustments to our organisational structure, given the challenges to be met over the next few years. Therefore, we created the President's Office and the Vice-Presidency in charge of Systems. I also decided to have the Human Resources Division report directly to me, given the importance of that activity. Thus, our Management Committee is comprised of five Vice-Presidents, the Manager of the President's Office and the Manager of Human Resources. All the members of the Committee have been working within the company for a number of years and have actively contributed to the excellent growth of Loto-Québec in recent years.

In accordance with the by-laws under which we are governed, the Board of Directors met on eleven occasions, while the Board's Audit Committee held three meetings. A new Committee was established: the Salary and Benefits Committee; it also held three meetings.

Sales

Total sales volume increased by 19.2%, while net profits rose by 19.7%, compared to the preceding fiscal year. We had forecast an increase in sales equivalent to the increase in the Consumer Price Index and a margin of profit equal to that of 1984-85. Our sales and profits were much higher than initially forecast thanks to an excellent consumer response to the bi-weekly LOTTO 6/49 draw format as well as the success of a new and unique lottery, Gala 15E.

PRESIDENT'S REPORT

Products

We made two major improvements to our products:

We have continued our policy of alternating and overlapping our Instant Lotteries, between $1 and $2 games. As a result, we were able not only to halt the decline in revenues but actually to increase them by more than 17%.

The number of draws for our star product, LOTTO 6/49, was increased last September from one to two per week: the modification resulted in a turnover more than 46% higher than the one for the corresponding months of the preceding year.

As part of the celebrations of its 15th Anniversary, our corporation offered its clientele an exceptional lottery of unprecedented attraction: in fact, Gala 15E offered six grand prizes of one million dollars each, one of which was eventually drawn from among nineteen finalists during a special anniversary gala celebration which was telecast throughout Québec.

This unique lottery met with resounding success, since almost all of the one million tickets printed were sold, generating gross revenues of some 14.5 million dollars.

Programs and salient facts

Later on in this report, each of the Vice-Presidents, as well as the Manager of the President's Office and the Manager of Human Resources, will present an outline of the salient facts which have highlighted their respective activities.

During the past year, we conceived a new long-range corporate plan. The plan will guide us in pursuit of our objectives of orderly and reasonable growth while benefiting from technological evolution to optimize our efficiency in providing services to the population.

National affairs

The imbroglio which had persisted between Federal and Provincial authorities regarding jurisdiction in the field of lotteries has had a satisfactory and permanent conclusion during the past year.

In fact, after five years of incessant battles against the competition, we have finally obtained the desired results: On the 3rd of June, the Federal Minister in charge of this matter signed an agreement with the Provinces whereby the Federal Government agreed to make the appropriate amendments to the Canadian Criminal Code granting the Provinces sole and exclusive jurisdiction in the field of lotteries.

Announced publicly on June 12, the agreement was accompanied by an agreement from the Provinces promising to pay the central government $100,000,000. over the next 3 years to help finance the 1988 Calgary Winter Olympic Games. Our balance sheet reflects the amounts allocated to this expense, as well as the transfers effected by virtue of the Federal-Provincial accord of 1979.

On December 21st, an amendment to the Canadian Criminal Code brought official ratification to the June agreement.

International affairs

In keeping with its policies, the Corporation has continued to play a very active role on the international scene.

The General Secretary's Office of the A.I.L.E. (International Association of State Lotteries), whose membership includes lottery organizations from more than 60 countries, continues to be managed by Loto-Québec. Moreover, we were successful in our bid to become the first Canadian hosts of the Annual General Assembly of the North-American Association of State and Provincial Lotteries, which will be held in Montreal in 1987.

We have also welcomed in our midst numerous foreign delegations of visitors

and trainees, particularly from Japan, Spain and Sweden. Reciprocally, we have assigned managerial personnel from Loto-Québec to lend their expertise to lottery organizations in the Cameroons, Senegal and Zaire.

Outlook 1986-1987

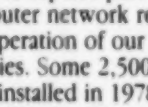
The coming fiscal year will be marked by several major challenges to our corporation.

The collective agreements with our employees and professionals expired on December 31, 1985; as a result, and simultaneously with the Government of Québec, we are in the process of negotiating with the unions representing those two groups. We expect to sign new agreements which will enable Loto-Québec to continue its mandate of providing ever improved products and services to the public, while paying fair and equitable salaries and maintaining a good working climate. In this regard, we are quite aware that the success of our company is dependent on the continued support of our entire staff.

We have requested authorization from the Government to replace part of our computer network related to the operation of our on-line lotteries. Some 2,500 terminals, installed in 1978, must be replaced; moreover, given the sustained growth of LOTTO 6/49, we must also increase the network's capacity to meet the demands of the next five years.

For the upcoming fiscal year, we are forecasting a rate of growth similar to the rate of inflation, not only for the Corporation's sales volume but also for its net profit. Consequently, any substantial increase in the dividend paid by Loto-Québec would have to be generated through the introduction of new types of gaming and betting.

David Clark



President

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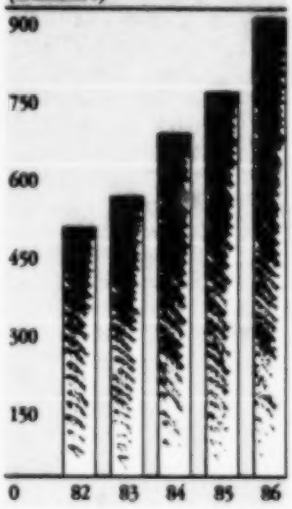

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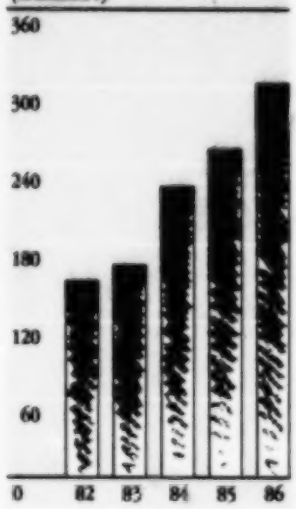

SALIENT FACTS

PRESIDENT'S OFFICE

The President's Office was established as part of the internal reorganization initiated in July 1985. Its principal mandate is to provide privileged assistance to the President Director-General in matters relating to different strategic dossiers: the reorganization of the Société's administrative structure, the elaboration of scenarios for internal management and different administrative opportunities, methods for developing sound management and good working conditions, as well as the organizational development of Loto-Québec.

The accomplishments and special projects brought to fruition by the President's Office include the implementation of planning procedures, elaboration of managerial and corporate indicators, finalization of the reorganization, definition of a new nomenclature for the enterprise, as well as certain strategic dossiers.

Several mandates of the organizational development department attached to the President's Office have been set in motion: namely, to broaden the scope for evaluating potential among the Professionals and to conduct a study bearing on the upgrading of this working tool; to implement the program of participatory management by objectives (D.P.O.) and the development program for Cadres, with a greater emphasis on managerial coaching in both instances; to apply, in a much more tangible fashion, the program dealing with the woman in the workplace and the assistance program to employees; finally, to conduct a study bearing on internal relations and communication.

VICE-PRESIDENCY, CORPORATE AFFAIRS

While the Vice-Presidency for Corporate Affairs retained its mandate of coordinating corporate orientations and that of supporting the administrative units of the Société as a whole, it underwent a significant modification in its fundamental operations. Consequently, during the past fiscal year, Corporate Planning and Public Affairs have been integrated with Corporate Affairs, while Systems & Methods, and Information Management (excluding Documentation Management) have been transferred under the Vice-Presidency, Systems. Corporate Security has been decentralized.

The Corporate Secretariat Section continued its support functions of coordinating the meetings of the Board of Directors and its standing Committees, as well as preparing the required forms for governmental approvals.

As for Legal Department, the highlight of fiscal 1985-86 was the conclusion of an agreement between the Federal government and the Provinces regarding jurisdictional competence in the field of lotteries and games. The Legal Department prepared and distributed various documents outlining and interpreting the present legal status of this domain. It also continued its support functions for the Société's business activities, particularly in matters relating to contracts, legal interpretations and affairs under litigation. The past fiscal year was also marked by the realization of some special projects, such as the Gala 15E Lottery and a professional training seminar concerning the application of certain legal imperatives. Lastly, the Legal Department initiated an extensive study pertaining to the legal status of computerized games.

Over and above its mandates pertaining to the current affairs of the Société, the Direction of Public Affairs has been entrusted with the management of the A.I.L.E. General Secretariat (International Association of State Lotteries) and the responsibility for hosting the 1987 Annual General Assembly of the North-American Association of State and Provincial Lotteries (NASPL).

This Direction also researched and published an historical document entitled "The Lottery...from Jacques Cartier's Day to Modern Times". It also played a vital role in the making and launching of a full-length

feature movie produced by Michel Moreau, "Le Million tout puissant". These projects served to spotlight the 15th Anniversary of the Société's institution. Lastly, the Direction created an International Lottery Center, which is now open to the general public at the Société's Head Office.

The Planning Department continued its task of implementing corporate planning procedures initiated during the preceding fiscal year; this meant the formulation of triennial tactical and strategic plans for the years 1986 to 1989, as well as the elaboration of operational plans for fiscal year 1986-87.

The Documentation Management Department presently groups two administrative units: the Document Management as such and the Documentation Center. The highlight of the year under review was the elaboration of a uniform filing system whose implementation should be completed during fiscal year 1986-87.

VICE-PRESIDENCY, NEW MARKETS

The mandate of the Vice-Presidency, New Markets is to explore and propose new avenues in the field of games and wagers and to ultimately develop those opportunities judged to be promising.

This Vice-Presidency groups two units: Development, whose task is to explore and test new types of games and wagers and to find new means of distributing the products of Loto-Québec; and Research, charged with the conduct of in-depth studies concerning the social and economic ramifications pertinent to the field of games and wagers.

During the past fiscal year, this Vice-Presidency examined new avenues and updated other options which had already been considered in the past. This was undertaken with the aim of advising the policy makers as to the possible short and medium range options available, specifically those which are likely to meet, in an orderly and measured approach, the demands for change, while still contributing to the growth of dividends to be remitted to the Government.

VICE-PRESIDENCY, HORSE-RACING
SODIC QUÉBEC INC.

Since elaborating and implementing its five-year plan for the period covering 1982 to 1987, SODIC QUÉBEC has enjoyed an excellent reputation among its varied clientèle whether they be horse breeders, horse owners or race-track administrators.

The Industry, nevertheless, has continued to decline. It is within this context, and at the request of the Finance Minister that SODIC filed a report in April 1985 on the status of the industry.

In December 1985, faced with a critical situation, the Government awarded SODIC an additional grant of some $900,000. as a stop-gap measure until the Industry itself can implement a course of action which horse-racing fans might find more creditable.

Since January 1986, there seems to be a growing tendency in that direction: in fact, the creation of an Industry Board is expected to be announced shortly. SODIC QUÉBEC, and all those concerned, will, in the course of the coming year, be able to determine whether or not the Industry can redress this situation.

SALIENT FACTS

VICE-PRESIDENCY, SYSTEMS

The Vice-Presidency, Systems has undergone a year of significant positionning. Several new concepts and orientations elaborated in the master plan for Information Processing, have been more clearly and more tangibly defined. The organization of tasks was modified not only to better reflect the corporate efforts of the "Systems" but also to distinguish clearly between activities connected with the development and processing of systems related to ongoing lottery operations and those activities related to systems for the Société's internal management operations. The far-reaching modifications affected more than 30% of the Société's personnel.

This Vice-Presidency has elaborated a series of projects designed to enhance the security of these systems. In a similar vein, a Quality-control Department was set up to ensure that the services provided conform to the highest standards.

With LOTTO 6/49 now holding two weekly draws and with a constant rise in the sales of semi-active lotteries, the Vice-Presidency has undertaken a complete review of the systems utilized for ongoing lottery operations; this task is one of considerable magnitude, made necessary by the gradual obsolescence of existing terminals, the need for providing consumers with more efficient services and the constant need for cost-effectiveness. Research and surveys on the utilization of terminals and their potential, conducted at the retailers and consumers levels, played a key role in determining the specification requirements of the new system. During the coming fiscal year, the acquisition and implementation phase will be effected.

The Vice-Presidency continued the development of powerful data processing systems to support the distribution of lotteries and payments to winners. The implementation of portable micro-computers, made available to representatives and to wholesalers, is now 60% complete. On a similar footing, several financial control functions were established to facilitate the collection and management of accounts receivable, while the essential aspects of the automated systems for payments to winners were consolidated.

Considerable progress was made in the area of integrated office and information systems, to the extent that an ever increasing number of users now have access to product sales information which can be processed and evaluated to determine the impact and tendencies of different marketing programs. The Division of Human Resources now has access to these same tools for processing data concerning personnel. The notable increase of micro-computerization is also attributable to a sensitization program carried out at the managerial level. The architecture to provide an environment compatible with the latest technology in integrated office systems has been set, so as to ensure an appreciable return on existing investments, without precluding a more gradual acceleration of the integration process.

Lastly, this Vice-Presidency has proceeded to set up various systems dealing with organization, methodology and information management for other sectors within the Société.

HUMAN RESOURCES DIVISION

During the past fiscal year, the Human Resources Division continued its review of policies and procedures relating to the management of personnel and undertook a gradual implementation of systems designed to ensure the availability of complete and uniform information to those responsible for the management of Human Resources.

The principle of remuneration based on market competition was applied for the vast majority of our managerial staff, and this within the norms and guidelines established by the Government.

As at March 31, 1986, the 709 staff positions of Loto-Québec were categorized as follows:

Management:	73
Professionals:	207
Administrative Agents:	24
Technicians:	79
Office Staff:	246
Representatives:	68
Labourers:	12

The Société also counts on independent wholesalers for the distribution of its products in rural and semi-rural regions throughout the Province.

The majority of employees are affiliated with either "Le Syndicat des travailleurs et travailleuses de Loto-Québec" (CSN) or with "Le Syndicat des professionnelles et professionnels du Gouvernement du Québec" (S.P.G.Q.).

The Collective Agreements having elapsed on December 31, 1985, the appropriate mechanisms were set in motion to ensure and maintain a healthy working environment propitious to the satisfactory negotiation of new agreements.

During the fiscal period just ended, the total aggregate disbursement of stipends, salaries, payments and social benefits to employees reached $26,434,000. as compared with $24,686,000. for 1984-1985.

VICE-PRESIDENCY, LOTTERIES

Fiscal year 1985-86 undoubtedly marked a turning point in the management of lotteries. Given the unprecedented public acceptance of computorised games, it was becoming essential to reassess these operations and to propose avenues which would ensure an optimal return during the coming years. Some of the projects were only begun during the past fiscal year while others were brought to fruition, enabling the Société to profit fully from their implementation. Among them are included the following:

- Marketing Division: the introduction of two weekly draws for LOTTO 6/49;
- Sales and Distribution Division: the use of portable micro-computers (M.O.P.) by wholesalers and representatives;
- Games-Network Processing Division (T.R.J.): the participation in the "New Games Environment" Program, bearing on a reassessment of existing terminals, a back-up processing center, an upgrading of the pool of terminals and the improvement of the data transmission network.

Product Performance

Due to the exceptional performance of certain products, sales for fiscal year 1985-86 greatly surpassed the objectives forecast, reaching a level of $883.1 million.

The numerous studies carried out in the analysis of market tendencies pointed, on the whole, to a slight drop in passive lotteries and to an even more significant increase in terminal-games. These proved true, with terminal-games contributing more than 63.6% of total sales.

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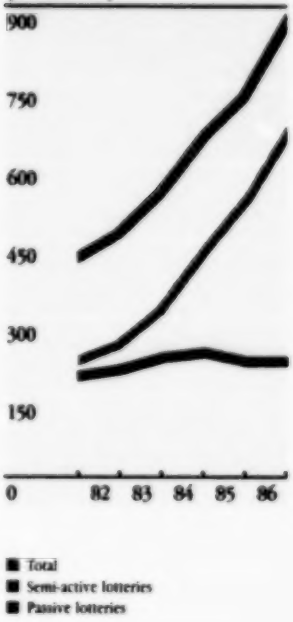
SALES BY PRODUCTS
From April 1st to March 31st
(in million $)



LOTTO 6/49, due to considerable jackpot accumulations and to its two weekly draws, begun last September, occupies first place and is in a class by itself, having contributed 48% of total sales, or $426.9 million.

The **6/36** has maintained its sales at the $2 million mark per week. A product which generates more activity during periods of jackpot accumulation, it offered the largest grand prize of its existence during the past fiscal year.

The **Quotidienne** (Daily) has more than maintained its share, with a regular clientèle, especially in urban centers.

The **Mini Loto** was modified last January; it now offers a new prize structure, creating more winners, and consequently has been well received in the market.

Inter Loto, the dean among Loto-Québec products, finds favour with a regular clientèle. Its sales are particularly brisk at periods of bonus prizes.

The **Provincial** has turned out to be a well-established product. A Canada-wide study has confirmed that this lottery is perceived as offering the best price-to-prize ratio, due to its five consecutive weekly draws at a unit cost of $5.00.

The **Super Loto** reached sales of $45.8 million. The bonus prizes it offered last spring (Cadillac cars) were a great success.

Fiscal year 1985-86 turned out to be a banner year for **Instant Lotteries**. Eight products were marketed, with total sales reaching $108.5 million. The introduction and overlapping of $1.00 and $2.00 games continued, with the launching of 5 and 3 new games respectively. Particular attention was devoted to the cosmetic of the tickets, their themes and prize structures. A new product, launched during the Holiday Season and offering cash and goods as prizes, was tremendously successful, generating $12 million in 8 weeks and attaining 150% of its forecast objectives.

A unique and distinctive product served to highlight Loto-Québec 15th Anniversary: Gala 15E, a blend of conventional and instant lottery, at $15.00 a ticket, was an exceptional success and generated close to $14.5 million in 6 weeks of sales. It culminated in the drawing and attribution, live on television, of a $1,000,000. grand prize.

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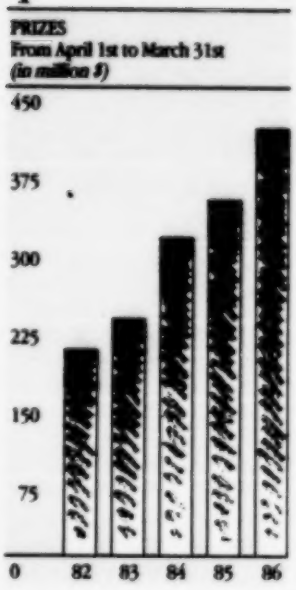


DIRECTORS' REPORT

The Board of Directors is responsible for the consolidated financial statements to the Shareholder. The responsibility for preparing them is delegated to General Management, while the Auditing Committee sees to revisions.

Management maintains a system of internal control in order to present reliable financial statements. The Internal Auditing Service constantly oversees the smooth functioning of the system.

The consolidated financial statements are prepared according to generally accepted accounting principles which, in certain cases, call for judgments on the part of Management.

By law, the Auditor-General of Québec is appointed as the auditor of the books and accounts of the Société.

The Auditing Committee and the Auditor-General meet with Management to discuss questions pertaining to auditing and to consolidated financial statements. The President Director-General is ex officio member of the Auditing Committee. The other members are not connected with the Société, except as administrators.

Upon recommendation of the Auditing Committee, the Board of Directors has approved the financial statements of the Société, for the fiscal year ended March 31, 1986.

David Clark

Jacques Desmeules, c.a.

AUDITOR'S REPORT

I have examined the consolidated balance sheet of Loto-Québec as at March 31, 1986, the consolidated statement of earnings, the consolidated statement of retained earnings, and the consolidated statement of changes in financial position for the year ended at that date. My examination was carried out according to generally accepted accounting standards and, accordingly, included such tests and other procedures as I considered necessary in the circumstances.

In my opinion, these consolidated financial statements present fairly the financial situation of Loto-Québec as at March 31, 1986 and, in like manner, the changes in the financial situation for the period ended at that date, in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

For the Auditor-General of Québec,

Robert Noël, c.a.
Assistant Auditor-General

Québec, May the 16th, 1986

CONSOLIDATED BALANCE SHEET
As at March 31, 1986

Loto-Québec
(L.R.Q., c. S-13.1)

ASSETS
(in thousands of dollars)

		1986	1985
			(note 13)
CURRENT			
	Cash	36,159	24,427
	Advance to Subsidiary Lotim Inc. *(note 3)*	1,233	1,047
	Receivables *(note 4)*	15,558	9,962
	Prepaid expenses	2,839	4,180
		55,789	39,616
INVESTMENT			
	Wholly-owned Subsidiary *(note 5)*	—	—
FIXED ASSETS *(note 6)*		49,940	50,929
		105,729	90,545

LIABILITIES
(in thousands of dollars)

		1986	1985
CURRENT			
	Bank loan	14,774	—
	Prizes payable	10,007	7,754
	Accounts payable and accrued liabilities	23,624	20,801
	Dividend to be paid to the Minister of Finance	29,000	—
	Unclaimed prizes *(note 7)*	3,256	2,170
	Deferred income — Lottery tickets	15,823	14,431
		96,484	45,156
LIABILITIES UNDER LEASE-PURCHASE CONTRACTS *(note 8)*		3,474	3,289

SHAREHOLDER'S EQUITY

Capital shares authorized, issued and paid: 1,700 shares with a par value of $100. each	170	170
Retained earnings	5,601	41,930
	5,771	42,100
	105,729	90,545

CONTINGENCIES *(note 12)*

On behalf of the Board of Directors
David Clark
Jacques Desmeules

CONSOLIDATED STATEMENT OF RETAINED EARNINGS

As at March 31, 1986

(In thousands of dollars)	1986	1985
Balance at beginning of year	41,930	29,011
Net income	302,671	252,919
	344,601	281,930
Dividend paid to the Minister of Finance	339,000	240,000
Balance at end of year	5,601	41,930

CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION

As at March 31, 1986

(In thousands of dollars)		1986	1985
SOURCE OF FUNDS			
	Net Income	302,671	252,919
	Depreciation of fixed assets	10,119	8,256
	Funds provided by operations	312,790	261,175
APPLICATION OF FUNDS			
	Dividend paid to the Minister of Finance	339,000	240,000
	Acquisition of fixed assets	7,164	3,607
	Acquisition of assets pursuant to lease-purchase contracts	1,966	61
	Obligations accruing from lease-purchase contracts	(185)	1,054
		347,945	244,722
CURRENT LIABILITIES OVER CURRENT ASSETS			
	Increase (reduction) during the period	35,155	(16,453)
	Balance at beginning of year	5,540	21,993
	Balance at end of year	40,695	5,540

CONSOLIDATED STATEMENT OF EARNINGS

As at March 31, 1986

(In thousands of dollars)		1986	1985
			(note 13)
SALES — Lottery tickets		883,121	741,102
COSTS OF SALES			
	Prizes paid	409,753	342,086
	Discounts to retailers	48,049	40,973
	Printing of tickets	18,757	17,454
		476,559	400,513
GROSS INCOME		406,562	340,589
OPERATING EXPENSES			
	Advertising and communications	17,630	16,079
	Distribution and sales	16,025	16,759
	Data processing	23,102	20,216
	Administration	17,802	18,014
	Research and Development	947	608
	Depreciation of fixed assets	10,119	8,256
		85,625	79,932
Income from interest — net *(note 9)*		3,035	2,131
		82,590	77,801
INCOME BEFORE EXTRAORDINARY ITEMS		323,972	262,788
	Payments to the Government of Canada further to its withdrawal from the conduct of lotteries *(note 10)*	20,797	9,468
	Special commissions to non-profit organizations *(note 11)*	504	401
		21,301	9,869
NET INCOME		302,671	252,919

March 31,1986

1. STATUTES AND FUNCTIONS

La Société des loteries et courses du Québec, also designated as Loto-Québec, is a provincial crown corporation all of whose shares are held by the Government of Québec. According to its enabling Act, its function is to conduct and manage lottery systems and, if so authorized by the Government, to hold races and promote the breeding of race horses in the province of Québec. In addition, and in return for financial or other considerations, the Société may offer consultation and implementation services in the areas of its competence.

2. SUMMARY OF MAIN ACCOUNTING POLICIES

The consolidated financial statements of Loto-Québec have been prepared by management in accordance with generally accepted accounting principles, within the reasonable limits of their relative importance and within the framework of the following accounting principles:

Consolidation

The consolidated financial statements group the accounts of Loto-Québec with those of Lotim Inc., a wholly-owned subsidiary, as at December 31, 1985.

Regarding the participation of Loto-Québec in SODIC Québec Inc., a wholly-owned subsidiary, it is carried at cost, since it is unlikely that the increase in the net assets of this subsidiary will effectively accrue to Loto-Québec.

Fixed assets

Fixed assets are presented at their original cost and are depreciated according to their estimated useful life, using the following straight-line method rates:

*Building	2%
Office furniture	10%
Equipment	33⅓% and 20%
Improvements to rental holding	20% and 10%
Rolling Stock	30%

*In joint tenancy with Immeubles Cadimont Inc.

Lease contracts

The assets and obligations accruing from lease-purchase contracts are entered at the current value of payments to be made and are treated as asset acquisition and loans; these assets are depreciated according to the same method utilized for other fixed assets.

The rents payable under lease-operation contracts are carried under consolidated earnings.

Income

Gross income from the sale of lottery tickets is recorded as of the date of the draw, with the exception of income originating from instant lotteries, which is entered at the time of sale.

Lottery tickets sold as at March 31 for draws subsequent to that date except for instant lotteries, are treated as deferred income. Discounts to retailers on these sales are carried as prepaid expenses.

Prizes paid

In addition to cash prizes, Loto-Québec also awards free tickets. The value ascribed to these prizes is equal to the price of sale and is entered under Sales as Income and under Prizes paid as Expenses.

3. ADVANCE TO SUBSIDIARY — LOTIM INC.

An advance made to this wholly-owned subsidiary from January 1986 to March 31, 1986; (in 1985: from January 1985 to March 31, 1985).

4. RECEIVABLES

(in thousands of dollars)	1986	1985
Retailers	6,242	6,366
Wholesalers	4,673	1,795
Interprovincial Lottery Corporation	4,115	1,447
Miscellaneous	528	354
	15,558	9,962

Loto-Québec holds demand notes or acknowledgments of debt covering permanent advances to wholesalers, as well as bank guarantees covering these advances in whole or in part.

5. INVESTMENT

As at March 31, 1986, Loto-Québec holds all the capital shares of SODIC Québec Inc.: that is, one common share at a par value of $10.00. The audited financial statements of SODIC Québec Inc. show a book value of $1,841,443 (as at March 31, 1985: $1,912,866).

6. FIXED ASSETS

(In thousands of dollars)	1986			1985
	Costs	Accumulated Depreciation	Net	Net
*Land	2,709	—	2,709	2,500
*Building	15,616	777	14,839	15,141
*Construction in progress	1,319	—	1,319	—
Leasehold improvements and outfitting	7,898	2,230	5,668	5,523
**Equipment	49,364	31,321	18,043	21,676
Office furniture and rolling stock	4,708	1,652	3,056	2,466
	81,614	35,980	45,634	47,306
Leaseholdings under Lease purchase contracts:				
Data-processing equipment	7,173	2,867	4,306	3,623
	88,787	38,847	49,940	50,929

*In joint tenancy with Immeubles Cadimont Inc.

**During the period just ended, the Société has reassessed the estimated useful life of its game-terminals; as a result, this equipment will now be depreciated over a period of five years, instead of the previous eight-year amortization period. This modification, applied on a prospective basis, has had the effect of reducing the net earning for the past fiscal year by $1,476,000.

7. UNCLAIMED PRIZES

Unclaimed prizes in the Mini Loto and Inter Loto are entered under a provision for their subsequent distribution as bonus prizes.

The same procedure applies to 6/36 prizes for which an allowance of $1,539,000. has been provided during the past fiscal year.

8. OBLIGATIONS ARISING FROM LEASE-PURCHASE CONTRACTS

(in thousands of dollars)	1986	1985
Obligations arising from lease-purchase contracts, at 17.5%, maturing until 1991	4,906	4,300
Payments maturing within one year (entered under Accounts Payable and Accrued Liabilities)	1,432	1,011
	3,474	3,289

The following table specifies the minimum payments to be made in pursuance of all obligations resulting from lease-purchase contracts:

(in thousands of dollars)	
1987	2,141
1988	2,141
1989	1,164
1990	863
1991	38
Total minimum payments	6,347
Amount of interest included in the minimum payments	1,441
	4,906

9. INTEREST INCOME — NET

(in thousands of dollars)	1986	1985
Interest on current investments	3,877	2,895
Less: Interest resulting from lease-purchase contracts	(842)	(764)
	3,035	2,131

10. PAYMENTS TO THE GOVERNMENT OF CANADA FURTHER TO ITS WITHDRAWAL FROM THE CONDUCT OF LOTTERIES

Under an agreement between the Provincial Governments and the Federal Government concerning the latter's withdrawal from the conduct of lotteries, the Provinces annually remit to the Federal Government the sum of 24 million dollars, in 1979 dollars. Moreover, under a second agreement, retroactive to 1985, the Provinces will also turn over to the Federal Government an additional sum of $100,000,000. distributed over the next three years.

The Québec government's share is payable by Loto-Québec according to an agreement concluded between the Provinces and the regional lottery corporations. Loto-Québec will turn over approximately 20 million dollars as its contribution for fiscal 1986-1987.

11. SPECIAL COMMISSIONS TO NON-PROFIT ORGANIZATIONS

Further to a decision by the Société's sole shareholder, a commission equal to the discount offered to retailers is granted to non-profit organizations engaged in the selling of lottery tickets through the "LOTOMATIQUE" subscription system.

12. LEASE OBLIGATIONS

The Société is committed to the rental of office space under lease agreements expiring at various intervals until 2003.

Rental expenditures for the year ended at March 31, 1986 are $2,947,516. (compared with $2,979,451 for 1985).

Minimum annual rental payments for the next five years are as follows:

(in thousands of dollars)	
1987	2,921
1988	2,680
1989	2,284
1990	1,934
1991	1,701

13. COMPARATIVE FIGURES

Certain figures for 1985 have been reclassified in order to conform to the presentation adopted for 1986.

COMMERCIAL HIGHLIGHTS

SALES

Total sales of the Société have risen to 883.1 million, an increase of 142 million over sales for the preceding fiscal year.

The following table outlines the performance of each product. Free tickets have been entered as an accounting item, a standard procedure in the field of lotteries.

SALES BY PRODUCT
(in thousands of dollars)

	1985/86	1984/85	Evolution
Passive lotteries			%
Mini Loto	70,101	73,828	(5.0)
Inter Loto	39,501	43,274	(8.7)
Provincial	42,506	45,595	(6.8)
Super Loto	45,821	49,320	(7.1)
Gala 15E	14,528	—	100.0
Sub-total	212,457	212,017	0.2
Semi-active lotteries			
6/36	116,908	108,840	7.4
La Quotidienne	18,253	17,815	2.5
LOTTO 6/49	426,920	309,709	37.8
Instant lotteries	108,583	92,721	17.1
Sub-total	670,664	529,085	21.1
TOTAL	883,121	741,102	16.1

PRIZES

In keeping with standard procedure, Loto-Québec pays out a guaranteed rate of return in prizes proportional to sales from its conventional lotteries: 44% for the Mini Loto, 41.5% for the Inter Loto, 45% each for the Provincial and Super Loto and 46.7% for Gala 15E. The unclaimed prizes from these lotteries are ultimately returned to consumers in the form of bonus prizes.

Since "on-line" terminal games do not entail any unsold tickets, Loto-Québec guarantees a percentage of return equivalent, in principle, to the amount of prizes to be claimed. The theoretical rate of return is 48% for the 6/36, 45% for the LOTTO 6/49 and 49% for La Quotidienne.

The rate of return in prizes for instant lotteries may vary slightly from one game to another. Loto-Québec generally sets the rate at between 48% and 50%. Free tickets are entered on the books under prizes paid.

Vendors of tickets that win prizes of $1,000. or more are awarded bonuses amounting to 1% of the prizes paid out to winners.

PRIZES PAID
(in thousand of dollars)

	1985/86	1984/85
Mini Loto	30,063	31,377
Inter Loto	16,393	17,958
Provincial	19,191	20,572
Super Loto	25,568	27,252
6/36	56,339	51,143
La Quotidienne	8,923	8,101
LOTTO 6/49	193,057	139,805
Instant lotteries	53,245	45,878
Gala 15E	6,974	—
TOTAL	409,753	342,086

COMMERCIAL HIGHLIGHTS

MARKETING

The short and medium term challenges facing the Marketing Division are indeed stimulating ones: to ensure the financial growth of Loto-Québec and to promote the diffusion of its various activities to the public at large.

The "revitalization" of the Mini Loto, the introduction of several instant lotteries and the institution of the twice weekly LOTTO 6/49 have taken up a major part of the activities of the existing products department. In the case of LOTTO 6/49, a follow-up and detailed analysis was made to determine the impact it would have on each of the other products.

The achievement of the year was undoubtedly that of the Gala 15E Lottery: its conception, its marketing, the press conferences, the television show, etc. Although the project was headed by the product development and market research department, nearly all activity sectors within the Société contributed their resources to this special product and played a vital role in its resounding success.

Three large-scale projects were initiated to further measure and analyse the lottery market: Project U.S.A., a series of coordinated meetings with numerous American Lottery organizations; a Canada-wide study, under the auspices of the Interprovincial Lotteries Corporation, bearing on product positionning; and RADAR, a major study undertaken to measure the perception and penetration of lotteries in Québec and to identify new marketable sectors. This last study should be completed during the first semester of 1986.

During the past year, tenders were received for new advertising contracts for Loto-Québec's products. After a lengthy process, the selection panel recommended that the existing agreements with the firms of Léveillé Benton & Bowles Inc. and BCP Stratégie Créativité Ltée be renewed for another three-year term. Twelve Québec advertising agencies were evaluated during this selection process.

The Communications Department, in addition to providing the results for all lotteries and offering consumers several publications pertaining to the lotteries and activities of Loto-Québec, also extended a welcome to winners at the Head Office of the Société.

Further in this report are outlined the principal activities of the Drawings and Sponsorship Departments, two other nerve-centers of the Marketing Division.

SALES AND DISTRIBUTION

The Sales and Distribution Division has experienced another excellent year, as the financial results of the Société show.

The beginning of the fiscal year was highlighted by the gradual implementation of portable micro-computers. Our retailers now have access to a new computerized framework endowed with unprecedented efficiency and quality.

In order to optimize the impact of our presence at points of sale, as well as that of the quality of services offered to our retailers, an exhaustive evaluation by district was carried out by our network development agents.

Continuous promotional efforts have greatly contributed to the increased popularity of group purchases of lotteries, to the substantial increase in revenues from terminals and to the success of the Gala 15E Lottery.

Moreover, several projects have either been outlined, pursued, or accomplished during the past fiscal year, namely the inauguration of a new Regional Office in Hull, serving the areas of Outaouais and Abitibi-Temiscamingue, as well as the creation and application of an experimental modular concept, designed to emphasize our visibility at points of sale.

COMMERCIAL HIGHLIGHTS

GAMES-NETWORK PROCESSING

This new Division was established during the past fiscal year. Its mission is to study and implement the technological resources necessary for the sale of lotteries through terminal systems.

The implementation of a second weekly draw in the LOTTO 6/49 has constituted a mandate of capital importance. This project enabled the Division to complete the reorganization of its material resources, without adding any equipment. It was, therefore, an unequivocal success, as is reflected in the new sales volume.

On another level, this Division has also reorganized its human resources in order to concentrate its efforts on the operation of lottery systems. During the fiscal period under review, it maintained an excellent rate of systems availability of 99.04%.

Finally, as regards the computerized network and its bank of game-terminals, the Division established a mobile unit comprised of specialized technicians whose main function is to prevent and resolve major problems. The Division was thus able to improve the output of its equipment and to rationalize the costs of the services.

FINANCE AND PHYSICAL RESOURCES

During the past fiscal year, this Division has seen its mandate and responsibilities broadened to encompass all operations regarding the suppliers of the Société and management of its buildings. This concentration of functions resulted in a better organization and an optimal utilization of the Société's financial and physical resources.

In addition to this step forward for the Division as a whole, other significant sectorial improvements were made. Thus, in the area of disbursements to winners, the Division, in collaboration with the Drawings Department and the Vice-Presidency, Systems, elaborated an auditing program for the validation of winning entries from terminal-games; this program will be supervised by the auditors of the draws. An auditing system bearing on the integrity of the data found in the prizes to be paid file has been worked out, enabling the Société to achieve maximum standards of security for its terminal-games.

The Division has implemented a computerized accounting system for lease-purchase contracts of equipment. Also accomplished was the computerization of the management and control over movable assets.

The Division has also channelled its efforts towards elaborating a new corporate strategy regarding supplies. A complete review of the situation was carried out; the strategy has been defined and will be applied from the outset of the coming fiscal year.

The Division also assumed the role of foreman in the outfitting of the interior of its Head Office and its Regional Offices. Moreover, it took charge of all the operations concerning the design and inauguration of the Regional Office in Hull.

Lastly, the Division greatly enhanced the quality and efficiency of its operations, thanks to the use of micro-computers in its financial analyses, in the calculation of lottery sales, in the preparation of cash budgets and the integration of the budgetary process with that of corporate planning.

KIOSKS

According to established procedures, the management of sales kiosks is entrusted to non-profit organizations who thereby obtain revenues for their charitable works.

The majority of these kiosks, which number 173, are operated by such organizations.

LOTOMATIQUE

Non-Profit organizations also have exclusive rights to the sale of lottery subscriptions for Loto-Québec. The

sales, through the "Lotomatique" system have increased by 9.7% over those of the preceding fiscal period.

45 additional Associations received accreditation, bringing the total number of organizations participating in this system to 329, as at March 31, 1986; the business volume of this sector was $9,433,679.

These organizations have thus benefitted from $525,493. in discounts and bonuses from Loto-Québec and $504,431. in government contributions.

DRAWINGS

Openess, Credibility, Security are three important watchwords connected with the drawing procedures.

During the year under review, two accomplishments in this area were particularly noteworthy: the first was the development of a parallel system for auditing entries into drawings, the second being the outfitting of a new drawing hall. These innovations enabled us to improve and integrate more fully the computerized operations relating specifically to the drawing process.

The telecast responsibilities for the draws were divided between Radio-Québec (for La Quotidienne) and TVA Network (for all other products). The Gala 15E draw was televised by Radio-Canada as part of a special live broadcast.

The firm of Samson Bélair, chartered accountants, was called upon further to tenders to carry out the functions of external auditors.

RETAILERS

The Société entrusts the retailing of its products to holders of commercial trade permits.

Some 12,533 merchants throughout Québec comprise this retail network.

The composition of the network, by category of business and region, is as follows:

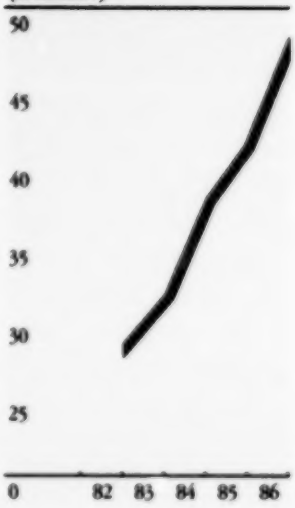
Tobacco and Convenience Stores	39.0%
Food Stores	28.0%
Financial Institutions	8.5%
Other Service Outlets	10.0%
Travelling Sales Persons	5.5%
Other Commercial Outlets	3.5%
Pharmacies	4.0%
Kiosks	1.5%
Laval	2,256
Montréal-Ouest	1,520
Québec	1,814
Trois-Rivières	1,015
Sherbrooke	1,156
Chicoutimi	730
Rimouski	608
Montréal-Est	1,670
Montréal-Sud	1,429
Lotomatique	335

Discounts to retailers reached some $48,049,000, as compared with $40,973,000 for the preceding fiscal year, an increase of 17.3%.

The discounts paid are of 10% on Mini Loto sales and 5% on the sales of all other products. Retailers also receive bonuses equivalent

5

DISCOUNTS TO RETAILERS
From April 1st to March 31st
(in million $)



to 1% of all prizes of $1,000. or more. In 1985-86, the Société paid out $1,686,553. to retailers in this capacity, including a record bonus of $76,502., bringing the total of bonuses and discounts to retailers to $49,735,553.

SOCIAL INVOLVEMENT

SPONSORSHIP PROGRAMS

The Société continued its social sponsorship programs of events.

Twenty-eight foot-races, held under the auspices of the Circuit Mini Loto, attracted more than 30,000 participants in all regions of Québec. The climax of this program was, without a doubt, the race that was to crown the élite among the best runners of the Province: that was "The Meet of Champions", held in Hull last October.

During the past fiscal year, thirty-three festivals and events promoting products or resources native to a particular region in Québec, were awarded sponsorships by the Société.

The year was also highlighted by the building of a mobile unit which will tour the Province, as early as 1986. Not only will this unit provide better services to the sponsored events but it will also be involved in a number of sales activities and promotions.

LOTO-QUÉBEC COLLECTIONS

The Société has continued to emphasize its involvement with the Arts.

Now in its eighth year, the Collection of original engravings has crowned two more prize-winning artists with the impending publication of their works in art-books form of limited edition. Testimonials to our folkloric heritage of Québécois or Amerindian Tales and Legends, these art-books are distributed to distinguished personalities within the Province and beyond or at special events.

One of the works selected this year adorns the pages of this report and, as is our custom, is offered to you in the form of an insert.

Moreover, the Société has instituted guidelines for the acquisition of works of art created by Québec artists; the aim of this endeavour is two-fold: to encourage today's artists in their creations and to enhance, through the exhibition of these works, the quality of working conditions in the Société's offices.

COMPARATIVE RESULTS FOR THE PAST FIVE YEARS

The consolidated results figures for the past five years attest, better than any words can, to the continuing growth of the Société and to the considerable sums it has collected and turned over to the Government, to the benefit of all Quebecers.

CONSOLIDATED RESULTS

(in thousands of dollars)		1986	1985	1984	1983	1982
SALES — Lottery tickets		883,121	741,102	662,177	541,411	479,652
COST OF SALES						
	Prizes paid	409,753	342,086	304,682	252,592	224,991
	Discounts to retailers	48,049	40,973	37,518	31,207	27,950
	Printing of tickets	18,757	17,454	17,306	16,961	17,526
		476,559	400,513	359,506	300,760	270,467
GROSS INCOME		406,562	340,589	302,671	240,651	209,185
OPERATION COSTS						
	Advertising and Communication	17,630	16,079	15,020	15,260	13,180
	Distribution and sales	16,025	16,759	16,867	16,117	13,783
	Information and systems	23,102	20,216	16,635	22,262	11,812
	Administration	17,802	18,014	14,327	11,113	9,426
	Research and development	947	608	—	—	—
	Depreciation of fixed assets	10,119	8,256	8,318	5,818	4,664
		85,625	79,932	71,167	70,570	52,865
	Income from interest — net	3,035	2,131	1,276	2,576	2,438
		82,590	77,801	69,891	67,994	50,427
INCOME BEFORE THE FOLLOWING ITEMS		323,972	262,788	232,780	172,657	158,758
	Payment to the Government of Canada further to its withdrawal from the conduct of lotteries	20,797	9,468	9,217	8,965	7,657
	Special commissions to non-profit organizations	504	401	443	277	170
		21,301	9,869	9,660	9,242	7,827
NET INCOME		302,671	252,919	223,120	163,415	150,931

SUBSIDIARIES

LOTIM INC.

LOTIM Inc., Loto-Québec's wholly-owned subsidiary, serves as an instrument for managing the Société's holding in the building located at 500 Sherbrooke West. This building, which houses Loto-Québec's Head Office, was purchased jointly in 1983 with a subsidiary of La Caisse de dépôt et placement du Québec. This past year of LOTIM's operations was marked by the launching of an extensive construction program aimed at correcting some of the building's deficiencies, at strengthening its position in the office space market and at initiating the refurbishing phase of its commercial facilities. The effects of these undertakings are already being felt and are reflected by an increasingly competitive position in the commercial buildings market.

The financial statements of LOTIM Inc. for the year ended December 31, 1985 have been consolidated with those of Loto-Québec.

SODIC QUÉBEC INC.

SODIC QUÉBEC INC. is a wholly-owned subsidiary of Loto-Québec whose activities are focused on the promotion and development of the Horse-Racing Industry in Québec.

Loto-Québec and its subsidiary do not form an integral whole so that the latter's accounts are not consolidated with those of the parent company.

SODIC QUÉBEC INC. prepares its own financial statements which are filed separately with the appropriate governmental authorities.

SOCIÉTÉ DES LOTERIES ET COURSES DU QUÉBEC

Public Affairs Directorate
Michel Labrosse

Design & Graphics
Ove Design Communication
Marketing Inc., Montreal

Typography
MGM Inc.
St-Laurent

Papers
Papiers fins Domtar
Beauharnois

Papiers Provincial
Georgetown

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Lithochrome Inc.
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THE HONOURABLE JUDGE'S CANE
A tale from the Bois-Francs region
by Joseph-Arthur Morissette

(Résumé)

Ever since his appointment, the Honourable Judge Anatole Dubois was never seen without his cane; a cane, made of ebony and adorned with a golden head, presented to him by friends as a tangible token of admiration upon his accession to the bench. And for twenty years thereafter the Honourable Judge and his cane were inseparable.

One day, however, he lost his precious staff through the window of a moving train.

The next day, he was seen entering his courtroom with an unsteady gait and a mournful gaze and proceeded to dismiss his cases, one by one, without even hearing them.

Then came the case of an individual accused of stealing a very valuable cane. "What evil must lurk in this man's soul!", thought the Judge. "He'll rue this day after I get through with him!"

— Accused, you have committed a crime which is only exceeded by murder and rape. This court sentences you to six months in prison. Court is adjourned.

Sympathizing with the grief-stricken plaintiff, the Honourable Judge hastened to meet him and see the object of the litigation. — Where did you get this cane? — I got it from the window of a passing train. — You have just proven to me that it is my cane. — If this cane is yours, then I am happy to return it to you. — What about the poor soul that I have just sentenced to six months in prison! — Well, he's the one who had stolen it; I merely found it. — You may go...

Contritely relinquishing the cane, the plaintiff took his leave, glad to have gotten off so lightly.

His Honour felt happy and rejuvenated; but he soon became absorbed in thought and his reflections led him to make two resolutions: never again would he render too hasty a verdict and never ever again would he thrust his cane through the window of a moving train.

- La canne de monsieur le juge, by *Joseph Arthur Morissette*, Ste-Foy, part of the Loto-Québec Collection.
- Collection Director: *Michel Labrosse*, Longueuil.
- Technical Coordinator: *Louis Pelletier*, St-Lambert.
- Conception and printing of original engraving: *Raymonde Béliveau*, Arthabaska.
- Linen-bound cover: *Pierre Ouvrard*, St-Paul-de-l'Île-aux-Noix.

The art book has a limited edition of 83: all prints are signed by the artist.